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ROLE OF CORPORATE REPORTING IN EMERGING ECONOMIES AS INVESTMENT INFORMATION

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ABSTRACT

The present study is based on the information about corporate reporting parameter and their standardized functionality procedure and distinctive perception about corporate disclosure is mandatory to understand the basic requirement of each and every person associated with investment. These financial information is accessed and required by many users at different phases of analyzing company strength and functioning structure. In this study we have tried to establish basic requirements that will be required on regular basis by individual investor at different phases.

Key word: Disclosure, Investor, Financial Reporting

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1. INTRODUCTION

Although sometimes shifted their lenses according to paradigms, understanding financial behavior has been a continual focus by the researchers. Financial intermediaries and policymakers also have been interested in this issue in terms of microeconomic (i.e., demand for their products) and macroeceonomic (i.e., savings or investments) perspectives respectively.

Effective information disclosure is a tool for investors to identify the opportunities in the business, now a day it's a mandatory requirement imposed by SEBI (Security exchange board of India) & ICAI (Institute of Chartered accountant of India). Information disclosure is essential for the effective operation of securities markets. Resources are not completely allocated among the market participant, fund providers identify to seek new opportunities for adding the extra values, while the market players have a faith for expecting the enough capital for operation to

generate the huge amount of profit. Necessary information always provides the clear cut guide lines; the proper disclosed information is called as communication technique among the active market participant.

The primary objective behind the capital market research have been to assess whether accounting numbers provide value-relevant information to market players, which is differentiate to all other general sources of large number of publicly accessible information. During the short span of time the information released among the investors the stock prices are highly volatile. Generally stock prices are relay on the accounting data which is available in public domain. The clear picture of the organization depends on the transparency how they disclosed the information for public domain. Hear the concept of financial reporting practicing concern with the accessibility sufficiency, and timeliness of related information about traded securities are important for market confidence, effectiveness and pricing efficiency. If investors are to make sound judgments about the value of securities, they must be completely informed of related facts. Since reported information disclosure is integral part for the effective operation of the capital and security markets, the regulatory bodies are always concern about the quality of information of financial and non financial items which disclosed by the firms. Today, there is a growing recognition by many of the regulatory bodies that the accounting reporting model has reached a tipping point and is failing to communicate what is important despite the volume of information being produced. This marks the reason for the evaluating of the regulatory framework for financial disclosures. The primary objective of this study is to evaluate the extent that potential users perceive information disclosed in the financial reports by companies listed at the NSE (National Stock exchange) as accessible, sufficient and useful to their investment decisions. Furthermore, this study examines whether multi-groups or clusters of investors have the same investment decision criteria within the different demographics characteristics like qualification, experience, industry, and amount of money invested etc.

2. LITERATURE REVIEW

In fact, the "unraveling result" by Grossman and Hart (1980), Grossman (1981), Milgrom (1981) and Milgrom and Roberts (1986) predicts that a firm that wants to maximize its share price discloses all its private information as long as (a) the disclosure is cost-less to the firm; (b) investors know that the firm has, in fact, private information; (c) all investors interpret the firm's disclosure in the same way and the firm knows how investors will interpret the firm's disclosure; (d) the firm may credibly disclose its private information; and (e) the firm cannot commit ex-ante to a certain disclosure policy. These results are driven by investors rationally implied that if a manager did not disclose the important information, his information would have caused investors and users to revise their advantage beliefs about firm worth downwards. As an output, the manager has to disclose this information to distinguish him from managers with even worse information. This holds true for all information (except the very worst possible outcome) leading to the "unraveling" of any withheld information.

Financial reporting usefulness has been one of the most important research areas in accounting. Since the seminal study of Ball and Brown (1968), extant accounting literature has well documented the usefulness of accounting earnings, book value and other items in the financial reports both in the U.S. as well as internationally [Graham and King (2000), Chen (2001)]. While most of these studies provide evidence that annual report is an important source of information, they also show a low association between accounting numbers and stock prices or returns. Some recent studies even report a decreasing trend in the value-relevance of financial statement information in the U.S. over the past decades (Francis and Schipper, 1999). Many prior studies empirically establish the usefulness of financial reports or other financial information by the statistical association between the financial information and stock prices or returns. Hodge (2003) suggests that a survey-based research can complement the archival-based

research in that it gathers data on a multitude of individual beliefs and practices to provide the underlying reasons for investors' behavior.

"Corporate disclosure with its determinant analysis has become a thrust area of research for various researchers and academicians. Many researchers have contributed towards exploration of this area of research. Still, many questions arise in the mind of an analyst or researcher as to why do different firms in the same industry have varying disclosure practices?. The need is to explore the area why the extent of information is differing among industries or in the same industry? Day by day the concept of disclosure is also changing. Now, it does not mean disclosing immaterial, irrelevant and vague information. Now, emphasis is laid on the qualitative aspect of information which is relevant to informed investors for making economic decisions. The main reason for this emphasis is that full and completed disclosure is the cornerstone to protect the shareholder's rights. Shareholders are the owners of a company and they should be informed about the working prospects of a company. Only through full and complete disclosure can shareholders feel confident that the firm in which they have invested their hard earned money is being operated with their best interests in mind. Forward-thinking companies report both financial and regulatory (operational) data to key external and internal constituents. They monitor market and stakeholder reactions to the reported information and then adapt their disclosure in response to such feedback as well as other market, regulatory and social developments. In return for such transparent and proactive reporting, the companies enjoy benefits such as stronger stakeholder relationships, greater support throughout all operations for reporting initiatives, larger following of investment analysts, easier access to capital and lower reputation risk"(Rajshekhar , Pillai, 2010).

"Corporate disclosure is critical for the functioning of an efficient capital market. Firms provide disclosure through regulated financial reports, including the financial statements, footnotes, management discussion and analysis, and other regulatory filings. In addition, some firms engage in voluntary communication, such as management forecasts, analysts' presentations and conference calls, press releases, internet sites, and other corporate reports. Finally, there are disclosures about firms by information intermediaries, such as financial analysts, industry experts, and the financial press. We believe that financial reporting and disclosure will continue to be a rich field of empirical enquiry. Further, There are significant changes in the economic environment, rapid technological innovation, the emergence of network organizations, changes in the business economics of audit firms and financial analysts, and the globalization of capital markets. These changes have the potential to alter the nature of financial reporting and disclosure, creating rich new opportunities for research" (Paul M, Krishna, 2001).

"Arthur Conan Doyle's ''dog that did not bark'' is a popular metaphor used in research literature for highlighting how framing our thoughts affects the results of our investigations. Financial reporting is no exception. Measurement and disclosure are two major elements of corporate financial reports. While interconnectivity of the broad range of measurement issues receives comprehensive attention, research and regulatory approaches to disclosure tend to be incremental (each disclosure issue considered individually and independently) and monotonic—more disclosure is better. This way of posing policy questions about disclosure may be easier, but is not necessarily accurate or effective. Analysis suggests that disclosure issues are interconnected in ways that raise serious questions about the incremental approach. Further, more disclosure may or may not be better, and what is better depends on the parties whose interests or viewpoints are under consideration".

"The diagnosis is that existing disclosure regulations are one sided, effectively encouraging firms to disclose any information that might be relevant, but failing to discourage disclosure of information that adds little to what investors already know. This one-sidedness limits investors'

ability to draw inferences that items the firm chooses not to disclose are not newsworthy (an inference Pragmatic theorists call ‘‘implicature’’). The solution is to encourage or require firms to supplement comprehensive disclosures with an ‘‘elevated’’ disclosure that is brief enough to force firms to be selective in choosing what information to include. Regulations can enhance implicature through rules that prohibit firms from elevating disclosures that are less newsworthy than disclosures that are not elevated”.

“Empirical research supports the following broad conclusions:

- Regulated financial reports are informative to investors, and the degree of informativeness varies systematically with firm and economy characteristics.
- Financial analysts add value in the capital market through their analysis of firms’ financial reporting decisions, forecasts of future earnings, and buy/sell recommendations.
- There is a market-driven demand for auditing services.
- Both financial analysts and auditors are imperfect intermediaries, in part because of incentive conflicts.
- Managers’ financial reporting and disclosure choices are associated with contracting, political cost, and capital market considerations.
- Disclosure is associated with stock price performance, bid-ask spreads, analysts’ following, and institutional ownership.

“To meet the ever increasing needs of the stake holders in the information disclosed by the companies, it is necessary that the companies disclose more and more about itself in the form of voluntary information. There is a genuine desire among investors to understand where value is coming from within the business at both a macro and micro level. Investors score companies very averagely on their ability to give meaningful insights into the future prospects of the business through their communications. With investor trust at an all-time low, companies must focus on communicating with investors in a open and transparent way in the tone of the communications.”

“Corporate disclosures (both mandatory financial reporting and voluntary disclosures made by firms’ investor relations programs or through other channels) have drawn significant attention in the wake of corporate scandals in recent years. High-quality disclosures may facilitate communication between management and the equity market, thereby reducing misvaluation and managerial myopia arising from information asymmetry and short-run market pressures. Therefore, managers with favorable (yet private) information about future earnings have strong incentives to improve disclosure quality to convey such information to investors. This argument implies a negative relationship between disclosure quality and the degree to which a firm’s stocks are undervalued. It represents an arbitrage opportunity for a strategy of buying stocks of firms with high-quality disclosures and shorting stocks of firms with low-quality disclosures. In addition, if high-quality disclosures were driven by managers’ desires to communicate favorable information to investors, one would expect positive links not only between disclosure quality and stock returns and market value, but also between disclosure quality and future operating performance.”

3. OBJECTIVES

(A) To know the perception about the information disclosed listed companies.

(B) To evaluate the type of information disclosed by companies.

(C) To identifies the usefulness of the information with respect to the various users.

4. OWNERSHIP STRUCTURE AND VOLUNTARY DISCLOSURES

Agency theory (Jensen & Meckling, 1976; Watts, 1977) suggests that where there is a separation of ownership and control of a firm, the potential for agency costs arises because of conflicts of interest between contracting parties. Fama and Jensen (1983) propose that where share ownership is widely held, the potential for conflicts between principal and agent is greater than in more closely held companies. As a result, information disclosure is likely to be greater in widely held firms so that principals can effectively monitor that their economic interests are optimized and agents can signal that they act in the best interests of the owners. In the Asian context, research is very limited on this issue. However, Hossain et al. (1994) found that ownership structure is statistically related to the level of information voluntarily disclosed by listed company.

2.. Impact of family ownership on voluntary disclosures , it seems that family-owned and –controlled companies are more in evidence than in western developed stock markets and that ‘‘insiders’’ control a significant proportion of listed companies. In Hong Kong, a survey conducted in 1997 by the HKSA confirmed the widespread view that the extent of control of listed companies in Hong Kong by one shareholder or a family group of shareholders is significant (HKSA, 1997). In Singapore, a similar situation seems to prevail though there is limited empirical evidence available owing to the difficulty of obtaining relevant data. Family-controlled firms have little motivation to disclose information in excess of mandatory requirements because the demand for public disclosure is relatively weak in comparison with companies that have wider ownership. In the context of the Chinese culture, with relatively high levels of collectivism and power distance, and strong uncertainty avoidance, it would also be expected that transparency and information disclosure levels would be lower compared to the US and UK markets (Gray, 1988).

Today, the methods which create value for companies have undergone a sea change. In the new globalized economy, when companies have edge to edge competition, the intangibles like strategies, brands, market leadership, management policies, etc., play a major role in creating value for a company. Very few intangibles are covered under the mandatory rules and regulations of accounting all over the world. Despite these regulatory limitations, an increasing number of companies are voluntarily opting to include information in their list of intangibles in the notes to their annual accounts or as an appendix in a narrative form. The narrative reporting on intangibles has not yet been regularized by various accounting authorities, but to have competitive edge in the market, a number of companies are voluntarily disclosing information on intangibles in their business review section along with the mandatory information on intangibles in the financial accounts.

5. DISCLOSURE INDEX

A disclosure index is used to examine whether corporations engage in disclosure practices of a particular information in annual reports (Marston and Shrives, 1991). Many researchers have utilized a disclosure index for examining the disclosure practices for intangibles of selected companies (Williams, 2001; Citron et al., 2005; Bergamini and Zambon, 2005; Kang, 2006). The index of disclosure on intangibles used in this paper consists of an extensive list of 180 information items, applicable to a wide range of users, which appear in an annual report

(See Appendix). The index includes both mandatory as well as voluntary disclosure items. These 180 items have been grouped into seven broad categories called parameters or groups of the Index Disclosure Index can be assigned either weighted or unweighted scores. A lot of controversy exists on this issue. A number of researchers have made use of the weighted disclosure index where items have been assigned weights according to either the importance or the type of disclosure (Bergamini and Zambon, 2005; Kang, 2006). On the other hand, Williams

(2001) and Citron, *et al* (2005) used un weighted index giving equal importance to all the disclosure items. The argument given by them is that annual reports are read by a wide variety of users and each class of user will attach different weights to an item. As a result, weighted index involves the issue of subjectivity. Further, Robbins and Austin (1986) found that using a weighted disclosure index does not materially affect the results of possible determinants of disclosure. This view is also supported by Cooke (1989) and Firth (1980).

6. DEPENDENT AND INDEPENDENT VARIABLES

The paper attempts to establish a cause and effect relationship between dependent variable, viz., disclosure score and independent variables, viz., organizational size, profitability, leverage, market-to-book value, and industry type.

(a) ***Organizational size****:* It has been measured in terms of total sales and total assets.

(b) ***Profitability:*** It has been measured in terms of return on assets (ROA) and return on equity (ROE). ROA is calculated as the ratio of net profit to total assets and ROE is calculated as the ratio of net profit to net worth or shareholders equity.

(c) ***Leverage*****:** It has been measured as the ratio of long term debt to shareholders equity.

(d) ***Market value to Book value****:* It has been measured as the ratio of market value to book value of the company.

(e) ***Industry type****:* It has been measured in terms of the amount of R&D expenditure disclosed in the annual report. Taking it as controlled dichotomous variable, coded as one (1) if the company discloses R&D expenditure in annual report or zero (0)

7. CONCLUSION

From this study, the overall findings suggest investor surrogates drawn from the accounting and finance professions largely ignore narrative social disclosures for their investment decision making. At best, the decision experiment elicited a 15% switch in investment funds. These findings are at odds with previous decision experiments, but consistent with many previous surveys of investor demands for social information. Within the confines of the experiment, this study has confirmed that accountants and investment analysts behave largely as they say they will. Although it is difficult to be sure, it is also probably the case that when previously asked for their perceptions to social disclosures, respondents bring to mind the typical narrative information presented in the Chairman's statements.

The discrepancies between this and the prior decision experiments are explained by the narrative social information not being sufficient to satisfy the analytical requirements of the investor types used in this study. Not surprisingly, the investor types chosen for this study seem most concerned with risk and return and, in their view, narrative social disclosures were insufficient to help assess impacts on these characteristics of the investment decision-making process. It would appear, however, that when social information is quantified (monetarily) and directly incorporated into the financial statements, it does provide a basis to assess risk and return, and will elicit decision reactions. Whether stronger decision reactions to narrative social disclosures would have come from other investor types and not just those investing for social and ethical motives, is unclear. Several previous surveys of non institutional investors suggest their demands for social information are greater than the accountants and investment analysts used in this study, and consequently a greater decision reaction might be expected. Follow-up decision experiments on other investor types would, therefore, provide a means not only to quantify the magnitude of any decision impact, but, again, to assess the correspondence between potential behaviour and stated attitudes.

Finally, there is no reason why decision should be limited to the assessment of information impacts. Extensions to the decision experiment used in this study may also come from alternative manipulations to the social information and alternative decision contexts. Not only could the experiments be used to assess the 'usefulness' of existing social and environmental information, they could also be used to assess the potential of yet-to-be-produced information. In line with Dierkes and Antal's (1985) framework, such experimental results may then provide a stronger basis on which to argue for increased corporate social disclosures.

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